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SMALL BUSINESS

Figuring out the true cost of complying with California regulations

A study puts the tab for the state's economy at \$492 billion a year. But critics say the study doesn't take into account the benefits the regulations may have.

By Cyndia Zwahlen

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Make no mistake, small-business owner Jane Skeeter isn't happy about the heavy burden she says government regulations put on her architectural-glass manufacturing plant in Chatsworth.

She knows that plenty of other California businesses have left the state for cheaper locales with fewer costly rules.

Skeeter, who employs 28 people at UltraGlas, doesn't plan to follow them. It may cost her more than she'd like to buy the equipment required by state air-quality rules, for example. But she says the benefit of cleaner air, including lower health bills and fewer sick days for her workers and others, has to be counted to calculate the true cost of a regulation.

That's not an easy job. Trying to figure out the real cost of government regulations for California small businesses has been the Holy Grail for business advocates for years.

They hope that once they find that number, they can use it to persuade lawmakers and government agencies to think twice before piling on more rules. The issue has heated up as California's unemployment rate has climbed and the state's economy has tanked.

So hopes were high when the state recently released its long-awaited, first-ever comprehensive look at how much regulations cost California small businesses. But for many, the results fell short.

The report puts the tab for the state's economy at \$492 billion a year in lower gross state product. That includes \$177 billion in direct costs such as lost business revenue and sales tax. It also counts indirect costs such as missing spending in the community by workers when jobs were lost or never created because of the expense small businesses incurred complying with regulations. That's almost half the \$1.1-trillion annual effect of federal regulations on the national economy, according to a study by the Small Business Administration.

The California study, required in a 2006 bill by Assemblyman Juan Arambula (unaffiliated-Fresno), counted as small any company with fewer than 500 employees, a measure often used by the federal government. The study was based on Forbes magazine's 2006 and 2007 rankings of the best states for businesses. Forbes compiled data from various studies and sources for the 30 measures it used to rank states in six categories. The California study extrapolated costs based on the state's rankings.

After the study was quietly posted on a state small-business website, some lawmakers and business groups seized on it as proof of the draconian nature of California regulations.

Other small-business advocates and some economists panned the study, questioning the method used to arrive at its conclusions. They also noted that the study didn't count the benefit that regulations may have on the economy.

The real need, others said, is a look at the cost of unnecessary regulation or even how much more it costs California small businesses to comply with regulations than large businesses, which is what the federal study found on a national level.

"It doesn't do the job," said Scott Hauge, president of the Small Business California advocacy group and owner of an insurance agency in San Francisco,

Was it unrealistic to expect a modest, \$85,000 study to deliver on all those fronts?

Study coauthor Sanjay B. Varshney, a professor of finance and dean of the College of Business Administration at Cal State Sacramento, acknowledged concerns about the methods used and called the study a first step.

"Given the scope of the assignment, the time and money allocated, it's a first step," said Varshney, who conducted the study with marketing professor Dennis H. Toolelian. "It's so complicated even the most sophisticated agencies and public policy groups have not been able to get a handle on this. I am hoping we opened the door and more groups will try to improve on it."

John Kabatek, who battles for small business as California executive director of the National Federation of Independent Businesses, has touted the study as proof that regulations hurt small businesses and the economy. But he said there was a need for additional research.

"While we believe it's a step in the right direction, it opens the door for more opportunities for additional studies to complement this," he said.

His group and others filed a Public Records Act request to try to spur release of the study, which had been turned in to the state a year ago.

David Neumark, professor of economics at UC Irvine, said the study's methodology, if applied to other states in the Forbes rankings, would wipe out smaller states' economic activity many times over.

"I am not disputing that regulations impose some costs. They surely do. And we should be asking which regulations are worth the costs they impose," said Neumark, a senior fellow at the Public Policy Institute of California. "But policy debate is not furthered by grossly exaggerated numbers that have no basis in reality."

Small-business owners such as UltraGlas' Skeeter say they just want an equitable regulatory environment.

"I am very, very conscientious about making sure we are in total compliance with all regulations," she said. "But if it's not fair, I object."

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